

May 15, 2012

Attn: **Chairman David Camp, House Committee on Ways and Means**
Re: **Hearing on Tax-Exempt Organizations**
From: **Daniel Borochoff, President of the CharityWatch**

CharityWatch (www.charitywatch.org), a rating and evaluation organization dedicated to helping donors make more informed giving decisions, offers the following comments on redesigning the IRS Form 990.

1. CharityWatch calls for public disclosure of the names and EINS of foreign grantees on the Form 990.

CharityWatch strongly believes that nonprofit organizations should be required to publicly disclose the name and EINs of foreign grantees. It is very wrong that tax-exempt organizations can distribute hundreds of millions of dollars of aid, in many cases the vast majority of their budgets, and leave the public entirely in the dark about what specific products were donated and what organizations, if any, received them.

An accountability black hole exists with respect to how charities are allowed to report international aid distributions on their tax forms. When a charity makes a grant or distributes aid within the U.S. worth \$5,000 or more it is required to disclose the name and address of the organization that received it on its IRS form 990 Schedule I. However, a charity distributing international aid is allowed in its public disclosures to hide the name and address of the foreign recipient and only disclose the major region of the world, for example, Africa, South America, or Europe, where it is distributed. Such aid is described by charities in only very general terms such as "medical supplies," "household & educational items," or "building materials." This lack of disclosure is very convenient for any charity that wants to exaggerate the value of its foreign grants, particularly if aid is in the form of donated goods or gifts-in-kind (GIK) because it knows there are no public records that an independent watchdog or donor can use to determine whether its valuation of an in-kind grant is reasonable or was even received by the reported recipient.

For example, one charity reported an international grant of over a million dollars in medical supplies and water purification systems on IRS form 990 Schedule I, which is ordinarily used to report grants to organizations in the United States. Because the grant recipient's name and EIN number were reported we had a rare opportunity to attempt to verify an international GIK grant. Upon contacting the organizational grant recipient we found out that it had not received the grant and had never heard of the charity that claimed to have made the donation.

To understand more about how many major charities have been taking advantage of the lack of disclosure of international grants to wildly overstate their work (by nearly 2,500% in the case of one charity), please read CharityWatch's recent articles, *The Alice in Wonderland World of Charity Valuation*, at <http://charitywatch.org/articles/valueinwonderland.html>, and *View Through the Looking Glass*, at http://charitywatch.org/articles/FoodforHungry_Valuations.html. This is a serious matter because it allows groups that overstate in-kind international grants to appear to be more efficient and attractive to donors than groups that more reasonably and honestly report their values, thus causing a serious misallocation of America's charitable resources.

CharityWatch has questioned the IRS in the past about why it would ask for disclosure of domestic grant recipients but not foreign ones. The response we received from an IRS official was that charities were concerned that this information could lead to terrorist attacks against a charity or its grant recipients. CharityWatch appreciates that some charities operate in dangerous areas such as in Iraq or Somalia where it might be advisable to conceal the identity of grant recipients. But if a charity is providing aid to organizations in Japan, Haiti or other non-terrorist hotbeds, CharityWatch believes public disclosure of recipient organizations should be required.

It is important that the decision regarding the disclosure of international grants not be based solely on the wishes of nonprofits and their associations. Nonprofits, like for-profits, want to avoid public scrutiny even if it helps to keep them honest and operating well. If the IRS were to ask nonprofits whether they thought the entire IRS form 990 should be abolished, many would readily say yes. Charities could come up with many reasons to eliminate the form 990 such as record keeping and reporting burdens, how the information could be misconstrued, etc... So it is understandable that many nonprofits endorse eliminating a schedule of their international grants, even if doing so is not in the public's best interest.

The U.S. government requires charities that receive funding from USAID to plaster aid boxes with a red, white and blue logo and the words “USAID from the American People” when operating in many areas, including the dangerous border between Pakistan and Afghanistan. Surely, this is more dangerous to aid workers than grant disclosures on a charity’s tax form that are not even publicly available on the internet until a year or more after the fact. An anti-American terrorist or violent aid thief is far more likely to learn of a U.S. charity’s presence in an area from its very publicly visible operations or by following foreign aid workers after they arrive or leave from the airport or other transportation hub, than from a charity’s tax form disclosure of its prior year grants.

The fact that we live in a dangerous world is not a legitimate reason to allow nonprofits to conceal all of their international grants. This line of reasoning could lead to nondisclosure of grants to domestic universities, community centers, youth camps and other places where terrorist events have occurred. Nonprofit organizations that operate in potentially dangerous places both in the U.S. and abroad take precautions such as hiring private security to protect workers and program participants. Many international charities receive protection from the U.S. military or local police. Other charities decide that it is too dangerous to work in some hot spots. Required disclosure of international grant recipients could even serve to decrease terrorism funding. A nonprofit that is unwittingly providing aid to a charity that is operating as a terrorist front organization could more easily be discovered if the names of its grantees are reported on form 990.

The overall benefits of sunlight on the international activities of charities far outweigh the small chance that a terrorist act would be committed because of a tax form disclosure that a U.S. charity is operating in their country. Rather than giving a blanket exemption for nonprofits to avoid all disclosure of its international grantees, we should look to USAID’s example and grant exceptions only in cases where a clear terrorist or other threat to a charity exists. It is vital that we do not allow the fear of terrorism to destroy the accountability and transparency of our nation’s charities.

2.CharityWatch calls for the enforcement of IRS reporting rules with regards to the disclosure of domestic grants.

Lack of disclosure is not just a problem with foreign grantees, but also domestic ones, even though it is in clear violation of IRS reporting rules. CharityWatch is finding more and more poorly performing nonprofits getting away with avoiding disclosure of basic information about their domestic grants, as required by IRS reporting rules. For instance, some charities will report the total amount of claimed domestic grants on the “Other expenses” line of the IRS Form 990, Part IX, “Statement of Functional Expenses,” rather than on the “Grants and other assistance to governments and organizations in the US” line, as a way to avoid disclosing what they are actually distributing and what groups are the recipients or grantees.

CharityWatch is very concerned that some charities are getting credit on their tax forms for distributing huge amounts of undisclosed, useless stuff. Failure to enforce proper reporting of grants, both domestic and foreign, allows charities to avoid the kind of scrutiny necessary to keep them honest and accountable.

3. CharityWatch calls for more disclosure with respect to compensation of charity officers, directors, trustees, and key employees.

The IRS’s 2008 redesigned Form 990 and subsequent revisions have been very helpful in providing watchdogs like CharityWatch and the broader public with more detailed information on charities’ financial activities. We appreciate the opportunity to provide the House Committee on Ways and Means with input on a very important disclosure that we believe is central to maintaining donors’ confidence and trust. Current IRS rules allow charities to hide from the public certain payments made to a nonprofit’s individual officers, directors, trustees, and key employees (ODTKEs). We believe this is wrong on several fronts and hope that the House Committee on Ways and Means will help close this accountability gap in its revisions to the current tax Form 990.

Under current Form 990 reporting rules, charities are required to break out compensation paid to each individual officer, director, trustee, or key employee. Schedule J provides for additional compensation disclosures of highly paid ODTKEs. On schedule L charities must report other

transactions between the charity and its ODTKEs, including loans to or from the organization, grants to close family members of ODTKEs, as well as excess benefit transactions between the charity and its ODTKEs. Such disclosures of compensation and related party transactions are vitally important to keeping charities and their executives honest by deterring those who have significant control over a nonprofit from using it for personal benefit. Those who might organize a charity primarily for personal gain are also deterred by these reporting requirements which highlight for public scrutiny the transactions between a charity and the people who control it.

Unfortunately, IRS reporting rules still allow for a major lapse in transparency with respect to compensation of a charity's ODTKEs. Under current rules, ODTKEs can receive certain payments from their charity without such payments being reported as compensation to the individuals who received them. For example, the president of a charity might receive \$300,000 in salary and retirement benefits from his organization annually. Such compensation is required to be broken out in Part VII of the Form 990, and reported in even greater detail on Schedule J. If this charity executive, rather than receiving compensation directly from the charity, instead sets up a for-profit company and receives this same amount of compensation in the form of consulting payments to his company, such compensation is not uniformly required to be broken out as salary or benefits to this individual officer on the charity's tax form. Instead, the charity is allowed to hide such payments to individual ODTKEs by reporting them as lump sums paid to the consulting company. Allowing nondisclosure of such compensation to individuals simply because payments were made indirectly is at best arbitrary, and at worst deprives the public of the information it needs to determine whether the total compensation paid to any individual ODTKE by their charity is reasonable for the services provided.

Lapses in compensation reporting that amount to loopholes are not helpful for maintaining donors' trust in the sector. Such lapses are also highly unfair to those charities and charity executives who are transparent about compensation in their financial reporting to the public. It is not fair that the president of one charity can brag about taking zero salary from his nonprofit while receiving large payments through his consulting or fundraising company, when the president of another charity has his feet held to the fire by donors for honestly reporting his individual salary on the charity's tax form. Under such a system, otherwise honest charities may

feel pressured to hide compensation from the public so they are not unfairly compared to other charities that may, in fact, pay higher compensation to their executives but are not required to break it out. It is necessary to level the playing field by requiring charities to report total compensation paid to individual ODTKEs, regardless of whether such compensation is paid by the charity directly as salary and benefits, or indirectly through outside companies.

Donors are at times too focused on what they perceive as the high levels of compensation received by some charity executives. We at CharityWatch try to put charity executives' salaries in perspective for donors who may not understand that nonprofits compete with the private sector for qualified employees and must offer reasonable compensation relative to the skills, education, and level of experience required for a specific position. Such scrutiny from donors motivates some charity executives to come up with creative ways to hide their compensation. While we understand that it is not always comfortable or easy to justify to donors why a high level of compensation may be appropriate for a specific ODTKE, this should not preclude the public from knowing the amount of tax subsidized dollars used to pay an individual charity executive.

An improved rule requiring charities to disclose all compensation paid to any individual ODTKE should require little additional effort by well-run organizations that already track personnel costs internally. Any charity with good governance practices is concerned about giving the appearance of a conflict of interest when it hires a company that employs or is owned by one of its ODTKEs, and therefore regularly monitors such transactions. The governance and management practices of charities that do not keep detailed records or regularly monitor personnel costs will be improved by an IRS disclosure rule that requires them to do so.

Charities already keep detailed records of employee compensation to meet reporting requirements for federal and state employment tax, workers' compensation and other insurance, and Form 990 disclosures. They also keep track of payments made to independent contractors, consulting companies, professional fundraisers and others for Forms 1099 and 990 reporting purposes, as well as to comply with state level solicitation rules. The recordkeeping and reporting burden a charity might incur to provide the public with a breakout of a charity executive's total compensation is minimal relative to the benefit that comes from giving donors and taxpayers the information they need to hold charities accountable for their dollars.

We thank you for giving CharityWatch an important forum for commenting on these issues. We hope the House Committee on Ways and Means will seriously consider supporting our suggested improvements in the redesign of the IRS Form 990 with regards to the disclosure of international grants and ODTKE compensation, and encourage the IRS to better enforce its requirement that nonprofits disclose their domestic grants.

Sincerely,

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Supplemental Sheet: Contact Information

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